

Trumbower Financial Advisors, LLC
3rd Quarter 2025
Investment Market Commentary

Too Hot to Handle?

Keep in mind this essay is intended to provide context as you review your portfolio's 3rd quarter 2025 performance and doesn't necessarily reflect events occurring as it is written.

Thumbing their collective noses at less than rosy labor, growth and inflation statistics, investors propelled stocks ahead through summer into fall. Big Tech and AI remained dominant themes, but equity markets were also propped up by swells of "buy the dip" participants and a

resurgence of memes. Latching onto names like Palantir, Robinhood Markets and Krispy Kreme, swarms of investors with no memory of the dot.com crisis are entertaining themselves with high octane options and trading apps styled to look like gambling sites. At over \$1 trillion, margin debt is at an all-time high. So far, hefty corporate earnings bolstered by cost cutting offered some rationale for exuberance. The measures that fattened profit margins, e.g. price increases, automation and thinning ranks of

managers, do not bode well for consumers, who's spending historically sustains economic growth. None of that restrained Wall Street during Q3.

Small Cap US stocks finally caught a wave cresting up 12.4%. The ride was less thrilling for Mid-Cap equities - up 5.6%. The S&P 500 Index delivered 8.1%. The S&P 500 Growth Index returned 9.8% compared to Value's 6.2%. Growth and Value were more closely aligned within Small

Selected Benchmark and Category Average Returns

Large Cap Equity

	(Total Return)	
Benchmark Indx & Category Average*	3 rd Q 2025	12 Mos.
S&P 500 Growth	9.80	26.91
Large Cap Gr Avg	7.39	21.16
S&P 500 Value	6.20	6.76
Large Cap Val Avg	5.36	9.59
S&P 500 Index	8.12	17.60
Large Cap Blnd Avg	6.87	14.43

Mid Cap Equity

	(Total Return)	
Benchmark Indx & Category Average*	3 rd Q 2025	12 Mos.
S&P MC 400 Growth	5.59	5.26
Mid Cap Gr Avg	4.45	13.26
S&P MC 400 Value	5.53	7.04
Mid Cap Val Avg	5.48	6.13
S&P 400 Index	5.55	6.13
Mid Cap Blnd Avg	4.78	6.83

Small Cap Equity

	(Total Return)	
Benchmark Indx & Category Average*	3 rd Q 2025	12 Mos.
Russell 2000 Growth	12.19	13.56
Small Cap Gr Avg	7.19	7.74
Russell 2000 Value	12.60	7.88
Small Cap Val Avg	8.24	5.11
Russell 2000	12.39	10.76
Small Cap Blnd Avg	8.18	5.88

International Equity

	(Total Return)	
Benchmark Indx & Category Average*	3 rd Q 2025	12 Mos.
MSCI EAFE	4.23	12.09
Intl Equity Avg	4.90	15.60
MSCI EM	10.64	17.32
EM Equity Avg	9.11	16.43

* **Category average** calculated using Morningstar Direct. Fund universe screened to include funds that meet the following criteria:

- A. M-Star Category consistent with designated asset class and management style.
- B. M-Star Style Box consistent with designated management style.
- C. Fund's Objective consistent with asset class.
- D. Excludes Index Funds.

We have not independently verified Morningstar data.

**3rd Quarter
Equity Market Results**

	3 rd Qtr. % Chg.	12-mo. % Chg.
S&P 500	8.12	17.60
S&P 400	5.55	6.13
Nasdaq 100	9.01	23.93
Russell 2000	12.39	10.76
MSCI EAFE	4.23	12.09
MSCI Emg Mkt	10.64	17.32

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and Mid Caps. Sector performance reflected the insatiable appetite for links to AI. Tech rose +11.5%, Communication Services returned +9.4% and Consumer Cyclical advanced +10.4% largely due to technology driven Tesla. The defensive Consumer Staples sector was left out in the cold ending in the red -2.6%.

Mag 7 Collectively Beat Broad Market

The Mag 7 outperformed the broader market but, once again, results for its components varied widely. Amazon, Microsoft and Meta earned low to no returns. Tesla rose 40% followed by Google (+37.4%), Apple (+24.3%) and Nvidia (+18.1%). Amazon, Microsoft, Google and Meta are known as “hyperscalers”. They provide cloud services and are scrambling to rapidly expand capacity necessary to accommodate AI data demands. They are abandoning enviable “capital light” business models in favor of “capital intense” strategies. Now spending 70%-80% of operating cash flow, they look more like traditional Industrials and Utilities. The transformation has yet to diminish price multiples although capital-heavy companies should be worth less per \$ of earnings.

Emerging Markets Were Big Winners

International stocks continued to reverse their long-term losing streak. The Developed index returned 4.8%, respectable but down from the torrid pace set during the first half of the year. Results were highly dispersed between countries. Spain led ahead 12.6% but Danish stocks declined -13.5%. One of the country’s champions, Orsted, nearly collapsed when the US stopped work on a huge wind energy project. Japan weathered another PM departure well rising 7.2%. Most of the AI action is centered in the US and Emerging Markets leaving Europe largely out of the Tech revelry.

Some have questioned why we maintained positions in Emerging Markets while they barely moved the needle for more than a decade. Well, those regions are finally showing signs of life and returned 10.6% for the quarter. The asset class is up 27.5% for the year, ahead of major US and Developed International markets. Unlike Europe, China’s hot stocks are AI competitors and benefited from the craze. In spite of tariff anxiety, Chinese equities returned over 20% in Q3. Korea’s AI-friendly companies like Samsung and SK Hynix contributed to a 12.5% return last quarter. Korean equities are up almost 55% for the year. India diluted performance with a -7% decline.

Bond Prices Up. Private Credit Concerning?

Equities weren’t the only hot tickets on the financial scene. Bond prices rose 2% as measured by the US Aggregate Index. The Fed’s September quarter point rate cut helped. Hungry for yields that could be fleeting, investors loaded up on corporate debt bidding up prices. The concern is that they may not be compensated for risk as evidenced by narrowing spreads between investment grade and high-yield. Another sizzling trend causing some to cringe is the explosion of private credit, i.e. loans to companies that generally cannot obtain financing from regulated banks. As we discussed in a recent newsletter, the likes of Blackstone, KKR and Apollo are aggressively marketing private credit products formerly reserved for accredited investors to the retail public. Historically default rates are relatively low but there hasn’t been a prolonged recession since private credit got into full swing in 2015.

Gold Rush

We don’t often talk about commodities, but we can’t ignore gold’s flaming run, up 18% in Q3 and 47% for the year. 2025 has been the best year for gold since 1979. It is hard to reconcile gold’s performance - rising in tandem with

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record breaking equity markets. Gold normally garners favor when financial assets are headed to hell in a hand basket. One answer may be robust central bank demand motivated by a desire to reduce dependence on the dollar. US investors have followed suit in a modern-day gold rush. Mining company stocks skyrocketed alongside AI darlings. It should be noted that multiyear gold rallies have been consistently followed by dramatic busts, although the up cycle may be prolonged by structural diversification of sovereign reserves out of dollars. The US dollar's first half free fall stalled and it bounced back up .9% during the quarter. The dollar is still down -9.9% for the year and could resume its retreat if US rates fall when most other countries are holding steady or ticking up.

AI Fuels Market Momentum - Or Bubble?

AI is clearly responsible for firing up demand for companies who are developers, warehousemen and purveyors of access to the technology. We scratched the surface of AI in late 2023 but we are increasingly aware of its profound influence on the financial instruments our clients own. It has been about two years since AI started flooding the airwaves and corporate strategic initiatives. It has gone from a promising but possible gimmick to a technology that many people expect will affect most businesses and employment opportunities not to mention everyday life. AI related stock prices are at peak levels and some observers wonder if investors are blowing a big bubble.

It is estimated that AI driven capital expenditures by the hyperscalers alone will exceed \$400 billion this year and may grow to over \$1 trillion by 2030. Since ChatGPT launched in 2022 AI linked companies have accounted for 90% of capital spending by the S&P 500's constituents. So far much of the infrastructure has been financed by cashflow

but that is starting to change. OpenAI has deals to build data centers that put it on the hook for ~\$1 trillion - and it is a start-up that still posts losses. Financing the spending binge is becoming circuitous and this amps up the risk that a misstep by one of the counterparties could bring the AI trade cascading down.

Open AI Partnerships

As an example, Nvidia is backing around \$100 billion of OpenAI's data center budget in return for equity. OpenAI agreed to buy Nvidia's hardware with cash. OpenAI signed a deal to purchase cloud computing from Oracle sending the latter's stock price up 36% in one day. Already highly leveraged, Oracle will have to borrow more to ramp up capacity. Broadcom's stock jumped 10% after it announced the development of customized chips for OpenAI. AMD's stock surged 24% on reports of its collaboration with OpenAI, which will use AMD chips in some of its models. OpenAI will receive warrants to purchase AMD stock as it achieves certain milestones further linking the companies' prospects for success and incentivizing both to invest in AI support systems. Finding power is a huge challenge. It isn't feasible to build new nuclear reactors in time and highly anticipated modular reactors have yet to materialize, so the projects present an opportunity for gas turbine manufacturers.

The problem is that OpenAI still needs around \$800 billion to build the 16 gigawatt data centers that its partners are counting on. If OpenAI can't come up with the money or can't deliver on its very ambitious plan for other reasons it could spark an avalanche of headaches for AI's most popular players and the ancillary businesses profiting from the build-out.

AI Outspends Consumers

Accounting for 2/3rds of GDP growth this year, massive investment in AI structures has recently eclipsed consumer consumption's

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contribution to the economy. Once the computing power is in place, what will generate sufficient revenue to recoup this capital much less deliver a return? *Morgan Stanley* estimated AI products generated around \$45 billion last year. Individuals are the largest users but most are accessing free versions. A recent *Census Bureau* survey reported 10% of businesses are using AI in some capacity. An *MIT* study found that 95% of the organizations using it have yet to recognize financial benefits. *Wall Street* economists agree that productivity has been enhanced within Tech companies and areas such as scientific research but there is no apparent relationship between AI use and lower head counts. Granted it takes time for businesses to learn how to use new technology effectively – and that might be how much maligned software companies can rebound - by facilitating the incorporation of AI tools into business applications.

Unlike the internet, which is practically free now that the networks are in place, AI requires a lot of power to run. Equipment and chips need to be replaced frequently, so prices for AI services have to go up. AI has to bestow big dividends in the form of superior productivity that will, in turn, enable business to afford the cost of access necessary to deliver a return on capital spending. Even if the payoff eventually comes, will it be timely enough? The dot.com bubble is a cautionary tale. The evolution of the internet was as revolutionary as the market expected, but many dot.com highflyers ran out of steam and capital during the 10+ years it took to get there.

AI Crowns Winners and Rewards Indexes

The concentration of wealth in the Mag 7 is evidence of investors' willingness to bet big on AI. This propensity is also manifested in the meteoric rise of smaller company stock prices

that were crowned winners because of their AI connections. Bloom Energy, a small fuel cell producer that might help data centers power up more quickly, rose 253% in Q3. Credo Technologies, which produces cables for servers, is up 117% this year. Even more extreme are prices of unprofitable quantum computing entities like IonQ or Rigetti Computing, a company with \$11 million in revenues and negative earnings yet it is valued at \$13 billion!

The AI dynamic has made it extremely challenging for active managers. On the one hand they struggle to hold the Mag 7 in weights that approximate the S&P 500. On the other hand, most managers adopt profitability, quality and/or valuation screens that keep them away from stocks that are being rewarded solely for their AI association. Market cap weighted index funds continue to buy expensive AI stocks because of their popularity, regardless of profitability or valuation considerations. This is reminiscent of the late 90's when disciplined active managers underperformed for several years while lower quality internet stocks persistently soared. When the tech bubble burst in 2000 many managers that stayed true to their philosophy were finally vindicated.

We are dealing with the potential for an AI revolution or the possibility of a bursting bubble by remaining balanced. Clients have exposure to AI through index ETFs but also through active managers that are guided by metrics other than mere popularity and may protect investors from being burned by stocks that are too hot to handle.

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The Big Beautiful Bill

Our quarterly newsletter focuses on financial markets and investment issues, but we would like to pass on a few general comments about recent tax legislation that may affect you. We will be in touch with our tax clients to explore opportunities and pitfalls in detail. Please note that every situation is different and these observations may not apply to you. We are happy to entertain questions.

1. Taxpayers who make large annual donations may want to accelerate them into 2025 to some extent. Beginning in 2026, in addition to existing limitations, only contributions in excess of .5% of adjusted gross income (“AGI”) will be deductible. Overall itemized deductions of taxpayers in the highest bracket will be reduced by 2/37ths of the lesser of the amount of deductions or the amount by which taxable income exceeds the dollar amount at which the 37% bracket begins. The intent is to limit tax benefits to 35% of deductions. This change in the law will likely favor making Qualified Charitable Distributions from IRAs to the extent allowable.
2. Individuals can deduct up to \$1,000 (Single) or \$2,000 (MFJ) of charitable contributions even if they do not itemize. This permanent provision replaces temporary “above the line” deductions (\$300 Single and \$600 MFJ).
3. Taxpayers over 65 can claim a \$6,000 deduction for tax years **2025-2028**. The deduction is reduced by 6% to the extent adjusted gross income exceeds \$75,000 (\$150,000 MFJ).
4. The limitation on deductions for state and local taxes is increased to \$40,000 effective in **2025** – but it is phased out for taxpayers with AGI above \$500,000 but not below \$10,000. The cap and the threshold go up by 1% through 2029. The provision sunsets in 2030.
5. For tax years **2025-2028** taxpayers can deduct (even if they do not itemize) up to \$10,000 of qualified car loan interest. The deduction is phased out starting at AGI of \$100,000 (\$200,000 MFJ). Debt must be secured by a new personal use vehicle with gross weight of under 14,000 pounds that was finally assembled in the USA and acquired after 2024.
6. The annual limit for 529 account distributions to cover an expanded list of K-12 education expenses increases to \$20,000. The list of expenses includes books and online instruction materials, tutoring, educational therapies for learning disabled students – among other things.
7. A 1% excise tax will be imposed on a US sender of a payment to a recipient overseas. The tax is not imposed if the transfer is withdrawn from a financial institution governed by Title 31, Chapter 53 of the US Code (regulates monetary transactions) or funded with a US-issued credit/debit card.
8. The general threshold for reporting non-employee compensation is increased from \$600 to \$2,000 after 2026 and increases annually by an inflation factor.
9. The Unified Estate and Gift Tax Credit is expanded to equal the Estate or Gift Tax imposed on a lifetime or postmortem transfer of \$15 million per person (\$30 million per married couple). Effective in 2026 and indexed annually for inflation.